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Yen In Slow Descent

Day by day the change is barely perceptible, but after six months the incremental movement is starting to add up. The yen is headed down. In early May it hit Y134.97 to the dollar, the least favorable rate since last September and within a couple yen of its nadir over the past 12 months. During the same period the yen has been as strong as Y121=$1.00, but on a month-to-month basis the Japanese currency has lost ground for six straight months.

1987. The hoped-for effect would be to reverse the recent undesirable drift of both the exchange rate and the current account. Such actions also would send a direct signal about BOJ's intentions to rein in inflation in Japan, an obvious concern based not only on the recent inflation numbers but indications that Japan's labor market continues to tighten.

Why has the central bank not acted? Japanese officials in the past have pointed out that the world economy benefits from someone pushing on the throttle when everyone else seems to be slamming on the brakes. If low interest rates in Japan keep the Japanese economy growing, the theory goes, Japan will import more, thereby offsetting some of the pain caused by tight monetary policies elsewhere. This argument may have become less compelling, however, as increased imports have been unable to reliably reduce Japan's current account imbalance. The tighter monetary policy implied by a discount rate hike would lead to an appreciation of the yen and squeeze the export side of that balance, which has been so troublesome, as well as increase imports.

Of course, tight monetary policies are unpopular with politicians. Some analysts have suggested that the extraordinary political logjam in Japan has led to unusual hesitation on raising the discount rate. As the political fog seemed to lift slightly in late April after Prime Minister Noboru Takeshita's resignation announcement, the yen appeared to rally slightly, only to fall back. Should the Bank of Japan raise its discount rate in the current political turbulence, currency markets probably would treat the yen kindly.

Douglas Ostrom

Japan's Balance Of Payments Surplus Shows Big Drop

Just when experts thought it was safe to conclude that Japan's balance of payments surplus was increasing again, the inevitable happened. In the first quarter of 1989 the current account surplus was 14.4 percent smaller than a year earlier (see Table 1). The numbers are the latest manifestation of the turmoil in the Japanese economy during the first three months of this year, when a widely fluctuating month-to-month pattern generated unpredictable results for the whole quarter. The current account surplus plummeted more than 50 percent compared to a year earlier in January but jumped nearly 17 percent in February before dropping 24 percent in March. The Showa emperor's death in January and his funeral in February coupled with skewed sales patterns in anticipation of the April 1 implementation of the consumption tax played havoc with the figures, just as they had with statistics released earlier on customs-clearance trade (see JEI Report No. 17B, April 28, 1989) and industrial production (JEI Report No. 18B, May 5, 1989).

Echoing patterns in some other recent quarters, the trade balance and the current account moved in opposite directions in the January-March 1989 period, primarily because of surging travel abroad. The jump in foreign travel largely was responsible for the fact that Japan's deficit in services more than doubled compared to a year earlier even though investment income from abroad, which reduces the deficit in services, also was up sharply.

The latest figures rounded out Japan's balance of payments data for the fiscal year that ended March 31. For FY 1988 the trade surplus grew 1.3 percent

Table 1: Japan's Balance of Payments

(in millions of dollars)

	Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1984	$44,257	$168,290	$124,033	$-7,747	$35,003	$-49,651
1985	55,986	174,015	118,029	-5,165	49,169	-64,542
1986	92,827	205,591	112,764	-4,932	85,845	-131,461
1987	96,386	224,605	128,219	-5,702	87,015	-136,532
1988 (p)	94,789	259,555	164,766	-11,167	79,488	-130,326
1987: I	23,373	50,515	27,142	-1,348	20,962	-32,209
II	25,038	55,823	30,785	-1,601	22,762	-44,365
III	23,585	56,600	33,015	-1,757	21,189	-22,023
IV	24,390	61,667	37,277	-996	22,102	-37,935
1988: I	21,021	59,345	38,324	-1,337	18,421	-15,142
II	22,448	63,559	41,111	-2,882	18,567	-36,556
III	23,765	65,989	42,224	-3,623	19,052	-42,214
IV (p)	27,555	70,662	43,107	-3,325	23,448	-36,414
1989: I (p)	21,280	66,680	45,400	-3,863	15,761	-5,487

Table 2: Japan's Net Purchases of Foreign Securities

(in millions of dollars)

	Bonds			Stocks		
	Purchases	Sales	Net	Purchases	Sales	Net
1984	$56,348	$29,575	$26,773	$1,570	$1,519	$51
1985	291,338	237,859	53,479	5,484	4,489	995
1986	1,346,989	1,253,965	93,024	20,917	13,869	7,048
1987	1,273,829	1,200,944	72,885	70,936	54,062	16,874
1988 (p)	1,364,061	1,278,249	85,812	76,560	73,567	2,993
1987: I	377,850	354,648	23,202	13,925	9,386	4,539
II	341,880	316,585	25,295	15,277	9,797	5,480
III	325,517	308,421	17,096	21,882	18,370	3,512
IV	228,582	221,290	7,292	19,852	16,509	3,343
1988: I	332,047	318,877	13,170	18,901	19,467	-566
II	401,293	374,371	26,922	20,518	20,643	-125
III	333,473	307,635	25,838	25,166	23,425	1,741
IV (p)	297,248	277,366	19,882	11,975	10,032	1,943
1989: I (p)	341,774	327,771	14,003	17,724	17,828	-104

Source for Tables 1-2: Bank of Japan

from FY 1987's level to $95.3 billion, but the current account surplus declined 8.9 percent to $77 billion. The trade surplus was $2 billion higher and the current account imbalance about $1 billion lower than Tokyo had estimated in the economic outlook issued in January, confounding critics who thought that the government had been optimistic about both figures. For FY 1989 the government expects the trade surplus to decline to $88 billion and the current account surplus to fall to $71.1 billion.

The effects of the agitation in the Japanese economy extended to the international capital statistics, the mirror image of the current account figures. Japan's net outflow of long-term capital declined sharply in the first quarter of 1989 compared to a year earlier, but the figure easily can be misinterpreted. It does not, for example, suggest that Japanese investors are losing interest in exporting capital to overseas markets, including the United States, a development that would be unsettling to many analysts of the U.S. economy. The numbers in Table 1 are net and include a variety of international long-term securities transactions, including participation in Japanese capital markets by foreign investors.

Table 2 gives a detailed breakdown of Japanese investments in foreign stocks and bonds. It shows that, while investors apparently withdrew modestly from overseas equity markets in the January-March 1989 period, they continued to add to their far larger offshore presence in bonds at almost the same rate as in recent quarters.

While Japanese investors more or less stayed on course in the most recent quarter, the same could not be said for foreign investors in Japan's markets. They poured $7.7 billion into equities, an action that was responsible for cutting Japan's net long-term capital outflow by more than half.

The latest figures suggest that, to the extent U.S. investors go on expanding their exposure in Japan, the continued flow of long-term capital in the opposite direction is even more critical. So far that flow is continuing. In future months, with the figures less affected by the extraordinary events that occurred in the first three months of this year, nervous analysts around the world will get better evidence about how worried they should be.

Douglas Ostrom

MITI To Revise Energy Demand Outlook

Confronted by a sudden surge in domestic energy demand, the Ministry of International Trade and Industry will revise its long-term energy outlook by the end of this year. The strong growth of energy use in 1988 surprised MITI officials and has led to renewed concern about Japan's energy supplies.

One mission of MITI's Agency of Natural Resources and Energy has been to project total Japanese energy demand, a task that became particularly important in the wake of the two oil price shocks of the 1970s. The most recent ANRE long-term outlooks date from November 16, 1983 and October 14, 1987 (see JEI Report No. 11A, March 18, 1988). The 1987 revision was undertaken for several reasons. The government projected that overall economic growth would slow as Japan entered the postindustrial phase of development; the shift away from

export-dependent growth to an economy driven by domestic demand would change energy consumption patterns; and the sharp appreciation of the yen would cut the cost of imported energy. In line with these changes, the 1987 outlook showed much slower overall energy consumption growth and a persistently large role for fossil fuels.

The rapid turnaround of Japanese industry in the face of the strong yen debunked MITI's 1987 predictions. Not only has the overall economic expansion picked up speed, but it has done so more strongly and more quickly than expected. Mirroring this jump in economic activity, energy consumption soared. From 0.4 percent growth in FY 1986, overall energy use jumped 4.8 percent in FY 1987 and is estimated to have risen more than 5 percent in FY 1988. According to ANRE, three factors led to the surge: sharply higher production by steel, petrochemical and other energy-intensive industries; greater numbers of large household appliances and cars, currently favored by consumers; and decreased interest in energy conservation by businesses and households because of lower prices.

Alongside greater demand, the recent rise in world crude oil prices has set off alarm bells at ANRE. The successful adjustment of Japanese firms to the stronger yen is due partly to the decline in the cost of energy inputs. MITI already has altered its medium-term predictions as shown by the five-year outlook for FY 1989 and beyond (see Table). Since the 1987 long-term outlook projected annual average energy consumption growth between FY 1986 and FY 2000 at just 1.3 percent, MITI felt forced to respond to the less favorable trends.

Jon Choy

Five-Year Outlook for Japanese Demand for Petroleum Products

(in thousands of kiloliters and percent)

Product	FY 1988 (estimated)	FY 1989 (projected)	Change	FY 1993 (projected)	1988-94 Average Annual Change
Gasoline	39,622	40,778	2.9%	44,284	2.2%
Naphtha	30,288	31,644	4.5	34,026	2.4
Jet Fuel	3,349	3,469	3.6	3,879	3.0
Kerosene	27,606	27,925	1.2	29,571	1.7
Light Fuel Oil	31,983	34,023	6.4	38,777	3.9
Fuel Oil A	25,138	26,265	4.5	28,821	2.8
Fuel Oil B	1,357	1,091	-19.6	557	-16.3
Fuel Oil C	43,810	46,389	5.9	47,502	1.6
Electric Power	20,919	23,231	11.1	24,018	2.8
Other	22,891	23,158	1.2	23,484	0.5
Liquefied Petroleum Gas*	17,117	17,549	2.5	18,948	2.1
Total	202,753	211,584	4.4	227,417	2.3

*in thousands of metric tons

Source: Ministry of International Trade and Industry